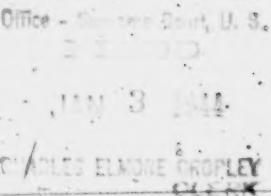


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No. 276.

IN THE

Supreme Court of the United States

October Term, 1943

THE SECURITY FLOUR MILLS COMPANY, Petitioner,
vs.
COMMISSIONER OF INTERNAL REVENUE, Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF OF PETITIONER.

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vs.
COMMISSIONER OF INTERNAL REVENUE, *Respondent*.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT
COURT OF APPEALS FOR THE TENTH CIRCUIT.

BRIEF OF PETITIONER.

Writ of certiorari was granted by This Court on October 11, 1943 (R. 74) to review the decree of the United States Circuit Court of Appeals for the Tenth Circuit entered in the above entitled cause on March 6, 1943 (R. 61).

That decree reversed an opinion of the United States Board of Tax Appeals promulgated November 12, 1941 (R. 32), which held that under Section 43 of the Revenue Act of 1934, Petitioner was entitled to deduct from 1935 income that portion thereof which represented processing taxes added to the sales price of flour in 1935 and which Petitioner refunded to its vendees in subsequent years after invalidation of the taxing act.

OPINIONS BELOW.

Opinion of the Tenth Circuit Court of Appeals was rendered March 6, 1943 (R. 61), appears at pages 61 through 71 of the Record, and is reported in 135 F. (2d) 165.

Opinion of the Board of Tax Appeals was rendered November 12, 1941 (R. 32), appears at pages 32 through 49 of the record, and is reported in 45 B. T. A. 671.

JURISDICTION.

(1) Jurisdiction of This Court is invoked under Section 240(a) of the Judicial Code, as amended (Feb. 13, 1925, c. 229, § 1, 43 Stat. 938; Jan. 31, 1928, c. 14, § 1, 45 Stat. 54; June 7, 1934, c. 426, 48 Stat. 926), 28 U. S. C. A. § 347.

(2) Decree of the Tenth Circuit Court of Appeals was entered March 6, 1943 (R. 61). Petition for rehearing was filed April 5, 1943 (R. 73). Substituted petition for rehearing was filed by leave of court May 22, 1943 (R. 74). The petition was denied May 22, 1943 (R. 73).

Petition for writ of certiorari was filed August 21, 1943 (R. 74). Writ of certiorari was granted by This Court on October 11, 1943 (R. 74).

STATEMENT.

Petitioner, a Kansas corporation (R. 34), is engaged in manufacturing and selling wheat flour (R. 34). As such it was subject at all times material herein to the Agricultural Adjustment Act (R. 34). Its tax returns were made upon the calendar year, accrual basis (R. 34).

During the calendar year 1935, petitioner sold flour at prices which consisted of the usual items of cost plus normal profit, but which included, in addition, an amount sufficient to cover the processing tax (R. 35).

Due to pendency of an injunction suit instituted to test constitutionality of the Agricultural Adjustment Act, petitioner paid no processing taxes to the fiscus subsequent to May 1, 1935 (R. 34). Instead, the amount of processing taxes "due" was impounded in a court designated depository from May through November, and was accrued on petitioner's books during December, 1935 (R. 34).

At the close of petitioner's 1935 calendar year, accrued liability for processing taxes amounted to \$105,054.70 (R. 34—total of impounded funds, December accrual, and reserve for increases). This approximate sum was deducted from 1935 income in petitioner's tax return for that year (R. 38-39).

On January 6, 1936, the Agricultural Adjustment Act was adjudged unconstitutional by This Court (R. 34-35), and all impounded monies were returned to petitioner (R. 35).

Immediately petitioner set up in its books a suspense account, "Reserve for Processing Tax, Claims, etc.", to which it credited the impounded funds returned to it (R. 35). This reserve actually exceeded in amount the monies returned (R. 35). By intervening petitions filed in the original injunction suit and by independent actions brought after the impounded monies were returned to petitioner, various vendees unsuccessfully attempted to establish claims to the specific monies impounded (R. 35). For several months following January 6, 1936, vendees suits, claims, and settlement negotiations, ne-

gotiations with the Commissioner, and proposed and eventual enactment of Titles III and VII of the Revenue Act of 1936 projected petitioner into a period of chaotic uncertainty (R. 35-37).

Eventually, petitioner refunded \$2,475.03 to its vendes in 1936, \$41,879.50 in 1937, and \$1,511.37 in 1938 (R. 37, 35)—a total refund of \$45,865.90 (R. 35, 37). These refunds were all made with respect to 1935 flour sales, in order to reimburse vendees for processing taxes included as part of the sales price of flour purchased by them in 1935, which taxes petitioner had not paid to the fiscus (R. 32, syl. 1 of B. T. A. opinion; R. 33).

The suspense account reflected these vendee reimbursements (R. 35), and was closed out on June 30, 1939, by a transfer to surplus of \$30,289.99 (R. 35).

In rendering its 1935 tax return, petitioner deducted from gross income the item of \$105,054.70 representing, as above noted, processing taxes impounded and those accrued for December, together with a reserve of \$1,183.64 (R. 33, lines 19-22; R. 39). This was deducted as an accrued tax liability (R. 33, lines 19-22).

On June 21, 1937, the Commissioner issued a deficiency notice, disallowing petitioner's 1935 tax deduction for taxes accrued, but not paid, during the injunctive period (R. 19, 39). In addition, the Commissioner refused to allow, in lieu of the accrued tax deduction, any deduction for the \$45,879.50 customer reimbursements actually paid (R. 19, 39). An income tax deficiency of \$14,702.48 and an excess profits tax liability of \$3,088.80 were assessed (R. 19-20, 33).

Whereupon petitioner, on August 9, 1937 (R. 5), petitioned the Board of Tax Appeals for a redetermination of said deficiency (R. 7-26). The Board upheld petitioner's contention (R. 32-49). The Commissioner ap-

pealed to the Tenth Circuit Court of Appeals which reversed the Board's decision (R. 61-72). The issues are now before This Court upon certiorari.

It should be noted that in an amended answer filed with the Board, the Commissioner asserted an increased deficiency based upon a tax refund alleged to have been granted petitioner in connection with a closing agreement under § 506 of the 1936 Revenue Act (R. 27-30). The issue with respect to this additional deficiency was separately passed on by the Board (R. 44-46).

On this one issue, the Board upheld the Commissioner (R. 44-46). In instituting appeal to the Tenth Circuit Court of Appeals, docketed as appeal number 2556 (R. 53), the Commissioner designedly omitted this issue (R. 53-54). Petitioner then filed a separate appeal, docketed number 2589 (R. 56), from the Board's decision on this single issue (R. 56-60). In its decision of March 6, 1943, the Circuit Court of Appeals reversed the Board on this issue (R. 66-67), separate judgment being rendered thereon (R. 72). In fact, entirely separate judgments were rendered in appeals number 2556 and 2589 (R. 72).

Petition for rehearing filed with the Circuit Court by petitioner was confined to appeal number 2556. (The petition does not appear in the record, but is shown at pages 77 through 83 of the record filed with petition for writ of certiorari.) Likewise, petitioner's petition for writ of certiorari to This Court confined itself to the issues involved in appeal number 2556.

No petition for rehearing was filed in appeal number 2589, no petition for writ of certiorari has been perfected, within three months from the date of that judg-

ment or otherwise, and said judgment is now final. Therefore, no consideration will be given herein to the issues determined in appeal number 2589.

SPECIFICATION OF ERRORS.

The Tenth Circuit Court of Appeals erred:

1. In holding Section 43 of the 1936 Revenue Act inapplicable to the case at bar and in refusing to permit petitioner to deduct from 1935 gross income that portion thereof subsequently refunded to its vendees.
2. In holding that the increment to 1935 flour sales prices, representing charges made for processing taxes then due, constituted income to petitioner in 1935 although such monies were subject to controversies throughout the 1935 taxable year, were carried by petitioner in a special reserve account, and were never recognized or treated as income by petitioner until the controversies were resolved in a subsequent taxable year.
3. In refusing to permit departure from normal, *annual* accounting methods where the abnormal increment to petitioner's 1935 income and the subsequent vendor reimbursements were both part of one enormous, extraordinary, *sui generis*, nonrecurring transaction.
4. In upholding the disallowance by Commissioner, in a subsequent taxable year, of petitioner's deduction for accrued tax liability taken and allowed in 1935, merely because the taxing statute was declared unconstitutional in 1936 and the tax was never paid by petitioner.

PRIMARY STATUTE INVOLVED.

The governing statute in this case is Section 43 of the Revenue Act of 1934, 48 Stat. 694. That portion thereof material herein reads:

"The deductions and credits provided for in this title shall be taken for the taxable year in which 'paid or accrued' or 'paid or incurred,' dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period"

SUMMARY OF ARGUMENT.

During 1935 petitioner sold flour tax on, the price including an amount sufficient to cover the then effective processing tax. This increment to normal income was offset by an accrued liability for processing taxes, which liability was deducted from 1935 income by petitioner in its income tax return for that year.

After adjudication of the taxing Act's unconstitutionality in 1936, petitioner, in 1936, 1937, and 1938, refunded to vendees \$45,865.90. These refunds constituted reimbursements of processing taxes collected by petitioner from vendees in 1935 as part of its flour sales price.

In 1937 the Commissioner disallowed the deduction from 1935 income for accrued processing taxes; at the same time he refused to allow a deduction from 1935 income of the amount thereof refunded to vendees as aforesaid.

As computed by the Commissioner, petitioner's income for 1935 was \$114,050.23. Deducting therefrom the vendee reimbursements per petitioner's contention shows an actual income for 1935 of \$68,184.33.

I.

The Board found, and neither the Commissioner nor the Tenth Circuit Court opinion denies, that only by accounting for reimbursements in 1935 can petitioner's income for that year be truly reflected. Section 43 of the 1936 Revenue Act permits deductions "to be taken in a year other than that of payment or accrual whenever this is necessary "in order to clearly reflect the income". Therefore these deductions should be taken against 1935 income. *Helvering v. Cannon Valley Milling Co.*, 129 F. (2d) 642 (C. C. A. 8, 1942), affirming 44 B. T. A. 763 (1941).

(a) Principal reliance of the Tenth Circuit Court's opinion is upon the rule that determination of tax liability upon an annual basis is the essence of the federal income tax system. However, it is equally fundamental that deductions must be taken in such manner as clearly to reflect income (Regs. 86, Article 41-1). And so far as possible deductions should be charged against the income in the production of which they are incurred. In any event, Section 43 is expressly designed to permit departure from the annual accounting principle whenever necessary to avoid distortion of income.

(b) The only decisions construing Section 43 are the Cannon case, *supra*, and the instant opinion of the Tenth Circuit Court of Appeals.

(c) The opinion below construes Section 43 as applicable only where a taxpayer makes expenditures in one year attributable or related to business operations extending over a number of years—such as rent and interest. It does so by relying upon committee reports in the House and Senate which preceded passage of Section 43. But the statute is unambiguous and therefore not

subject to interpretation by resort to extraneous evidence. Further, the reports do not support the construction adopted.

(d) Detailed analysis of the facts herein plainly support the Board's finding that petitioner's proposed accounting method truly reflects, and the Commissioner's distorts, petitioner's 1935 income.

(e) At the close of 1935, petitioner's right to deduct its liability for accrued processing taxes from 1935 gross income was unassailable. The Commissioner thereafter, in 1937, reopened the calendar year 1935 and disallowed the deduction upon the basis of a fact (adjudication of the A. A. A.'s unconstitutionality) transpiring in 1936. Justice requires his reopening the year for all purposes and permitting petitioner to substitute the vendee reimbursements for the tax deduction.

(f) There is no factual difference between the Cannon case and the case at bar.

The only distinction suggested by the Court is that there tax returns for 1935, 1936, 1937, and 1938 were in evidence, whereas here only those for 1935 and 1937 were introduced. But the Cannon case is not based upon these returns. Further, the Tenth Circuit Court's opinion, confining Section 43 to deductions for rent, interest, "etc.", would deny to the taxpayer in the Cannon case the right to resort to the statute. Again, the evidence in the two cases is almost identical. Finally, the only year in controversy here is 1935—and the evidence as to that year is complete.

II.

The monies returned to petitioner after the A. A. A. was permanently enjoined were "hot monies", subject to the substantial contingency of recapture by the fis-

cus and/or reimbursement to vendees. Hence, petitioner refused to exercise dominion over them, set them up in a special suspense account, and did not recognize them as income until 1937 when these controversies were ultimately determined. Hence, they did not become "income" until 1937. *Commissioner v. Brown*, 54 F. (2d) 563 (C. C. A. 1, 1931).

III.

The facts herein are unique. The items involved are, comparatively, enormous. And all relevant facts are part and parcel of one continuing transaction: Nor is there any likelihood of recurrence. Hence, ordinary tax laws are inapplicable, and the "transaction" principle should be followed. *Bowers v. Kerbaugh-Empire Co.*, 271 U. S. 170, 70 L. ed. 886 (1926); *Comm'r. v. Darnell*, 60 F. (2f) 82 (C.C.A. 6, 1932); *George G. Moore*, 19 B. T. A. 364 (1930).

IV.

The deduction for 1935 accrued processing tax liability, properly taken in the 1935 return, cannot be disallowed notwithstanding petitioner never paid the tax as a result of the statute's invalidation in 1936. *Davies' Estate v. Comm'r.*, 126 F. (2d) 294 (C.C.A. 6, 1942); *J. H. Dougherty's Sons, Inv. v. Comm'r.*, 121 F. (2d) 700 (C. C. A. 3, 1941).

ARGUMENT AND AUTHORITIES.**I.**

IN ORDER "TO CLEARLY REFLECT INCOME", SECTION 43 PERMITS PETITIONER TO DEDUCT FROM 1935 GROSS INCOME THE CUSTOMER REIMBURSEMENTS MADE IN SUBSEQUENT YEARS.

A. Of the Applicable Law.

The primary issue here involved must be determined with little aid from precedent. Although it, or its counterpart, has been in the statute books since 1924, Section 43 of the Revenue Act of 1936 has never been judicially construed by This Court. It has, in fact, been construed only twice by the Federal courts: once in *Helvering v. Cannon Valley Milling Co.*, 129 F. (2d) 642 (C.C.A. 8, 1942), affirming 44 B. T. A. 763 (1941), and again in the Tenth Circuit Court of Appeals' decision in the instant case. With the exception of those two opinions, the authorities hereinafter cited, as well as those the Commissioner will cite, are relevant only by analogy. As was said by the Board in the *Cannon* case, *supra*, the authorities there adduced:

" . . . furnish but slight aid in determining the issue now before us. Despite the presence of the remedial provision [Sec. 43] in all of the revenue acts from 1924 to the present few instances have arisen in which the courts or this Board have had occasion to consider it. Perhaps this is so because, in the great majority of cases, income is clearly reflected by taking the deductions and credits in accordance with the method of accounting employed. Yet the provision is not meaningless and should not be ignored." (44 B. T. A. at 770).

The refusal of the Commissioner and of the Tenth Circuit Court of Appeals to permit petitioner's deduction is premised largely upon the proposition that determination of tax liability *upon an annual basis* is the essence of the federal income tax system. This we concede. There are, however, other vital considerations which should not be ignored.

Another fundamental precept of all taxation statutes since 1916, and one which of necessity frequently conflicts with the annual accounting requirement, is that income must be truly reflected. Even the Commissioner's own regulations attest to this. For example, see Regulations 86, Article 41-1:

"The time as of which any item of gross income or any deduction is to be accounted for must be determined in the light of the fundamental rule that the computation shall be made in such a manner as clearly reflects the taxpayer's income." (Italics ours).

In seeking to meet the requirement of true income reflection Congress and courts have alike countenanced departures from the rigid annual accounting concept. "Federal income tax legislation", says the court in the Cannon case, *supra*, 129 F. (2d) at 646, footnote 3, "is a progressive growth based upon developing experience." Continuing, the court observes:

"Several distinct lines of growth are evident. One of these concerns us here. While an annual period has always been maintained as the normal basis for taxation, experience soon developed that injustice would result in some instances from a strict adherence thereto. This experience led the Congress to provide departures from this annual basis in specified situations for the purpose of avoiding injustice."

Thus the original Act of 1909 required computation of taxes strictly upon the "cash basis" (although the Treasury made exceptions with reference to accounts receivable and payable). This method, adhering strictly to the annual accounting period, was unworkable. The first departure therefrom was the 1913 Act which introduced the phrase "arising or accruing". This was enlarged by the 1916 Act (Sec. 8 (g); cf. Section 13(a), (b), (d)) which permitted preparation of tax returns upon *any* basis which truly reflected income. Section 212(b) of the 1918 Act (which became Section 41 of the Acts of 1928, 1932, and 1934) elaborated upon the principle permitting and requiring computation of taxable income to be according to that method of accounting which truly reflected income. The 1928 Act introduced present Section 42 relating to allocation of items of gross income. Finally, Section 200(d) of the 1924 Act (which became Section 43 of the 1928 and subsequent Acts) expressly provided deductions *might be taken as of a different period than the taxable year in which paid, incurred, or accrued; "in order to clearly reflect the income"*. (Compare a somewhat similar provision of the 1921 Act—Sec. (a) (4)—relating and confined to "losses".)

These, together with other enactments, constitute a definite qualification of the Procrustean annual accounting concept. For detailed discussion of this evolution, see 2 Mertens, *The Law of Federal Income Taxation* (1942), § 12.05, pages 128 *et seq.*, and *Helvering v. Enright Estate*, 312 U. S. 636, 85 L. ed. 1093 (1941). In 2 Mertens, *supra*, § 12.06, p. 138, that noted tax authority says:

"While the taxable year is inelastic, there is considerable scope for elasticity in fitting the items of

deduction or income into the taxable period . . . The 'tide of income' continues, despite all efforts to hold it within specific periods, to ebb and flow over the dividing lines between the statutory taxable years.

"The purpose of many of the statutory provisions, regulations, and decisions on methods of accounting is to overcome, so far as may be, the artificiality of the taxable year as a unit of time."

These enactments further constitute a definite attempt to build a tax system which accords with sound business accounting methods. Taxation is today an intensely practical matter (*Farmers Loan & Trust Co. v. Minnesota*, 280 U. S. 204, 212, 74 L. ed. 371, 1930), and the trend is towards acceptance of business accounting practices. As Dr. Roswell Magill said, in an address before the American Bar Association on August 28, 1934:

"One final trend to which I shall briefly refer before going on to consider what the future may hold is the increasing acceptance of accounting principles in the statute and in the decisions. Some lawyers will dispute the accuracy of this statement, but as courts and legislators have come to understand better that accountants have a reasonably adequate and tested technique for arriving at an accurate statement of business profits, there has been a tendency to bring the law and practice into harmony with this pattern. In my judgment, this trend is wholly desirable. The more nearly the income subjected to tax corresponds with the income determined for ordinary business purposes, the less the encouragement to artificial transactions for tax purposes only."

This brings us to another doctrine relevant to the issue under consideration. One of the touchstones of business

accounting is that *expenditures should be related to and charged against the income in the production of which they have been incurred.* Victor H. Stempf, "A Critique of the Tentative Statement of Accounting Principles", *The Accounting Review* (March, 1938), says:

"One of the fundamental tenets of accounting requires that expenses should be charged against the income in the production of which they have been incurred."

"The income statement for a year should reflect all determinable items *applicable to the year*, whether recurring, nonrecurring or extraordinary, and minor items *applicable to prior years* which will not distort the results of the current year. On the other hand, charges and credits applicable to prior years which would tend to distort current years' net results should be carried to earned surplus."

"It is unsound to credit extraordinary incomes to current profit and loss and to charge extraordinary losses to current surplus. Both should be handled consistently and both should be disclosed." (Italics added).

And see Magill, *Taxable Income* (1936), p. 167:

"The general theory of accrual accounting, as distinguished from accounting on a cash receipts basis, is to enter income as of the period during which it has been earned, though perhaps not collected, and to charge against such income 'the expenses incurred in and properly attributable to the process of earning income during that period', whether or not actually paid."

Although Mr. Mertens considers this principle of correlating income and deductions an "exception" to be

sparingly applied (2 Mertens, *supra*, § 12.23), it has found increasing recognition by the courts. (1) And see Paul & Mertens, *Law of Federal Income Taxation* (1930), § 11.104, p. 594.

From the foregoing it must be apparent the annual accounting principle is not inexorably applied. Neither, we submit, is the law concerning when a given item is deductible as clearly settled as the opinion below assumes. Thus see § 12.01, pages 119-120, of 2 Mertens, *supra*:

"The fundamental questions of when items become income and when items are deductible, despite years of extensive litigation, remain today not only as troublesome as ever, but even more so. . . . The struggle to adhere to the fundamental requirement that both income and deductions be fitted into a lim-

(1) *Helvering v. Union Pacific Rly. Co.*, 293 U. S. 282, 79 L. ed. 363 (1934); *American National Co. v. U. S.*, 274 U. S. 99, 74 L. ed. 946 (1927); *U. S. v. Anderson*, 269 U. S. 422, 70 L. ed. 347 (1926); *Brooklyn Union Gas Co. v. Comm'r.*, 62 F. (2d) 505 (C. C. A. 2d, 1933); *Comin'r. v. Old Dominion Steam Ship Co.*, 47 F. (2d) 148 (C. C. A. 2d, 1931); *Hyams Coal Co. v. U. S.*, 26 F. (2d) 805 (E. D. La., 1928); *Bonwit, Teller & Co. v. Comm'r.*, 53 F. (2d) 381 (C. C. A. 2d, 1931); *Allard & Bros. v. U. S.*, 28 F. (2d) 792 (D. Mass., 1928); *Miller & Vidor Lumber Co. v. Comm'r.*, 39 F. (2d) 890 (C. C. A. 5th, 1930); *Bonded Mortgage Co. v. Comm'r.*, 70 F. (2d) 341 (C. C. A. 4, 1934); *Lichtenberger-Ferguson Co. v. Welch*, 54 F. (2d) 570 (C. C. A. 9, 1931); and *Godfrey L. Cabot, Inc. v. Comm'r.*, 40 B. T. A. 64 (1939). See, also, *Figueroa Machine Co. v. U. S.*, 282 U. S. 375, 75 L. ed. 397 (1931); *Helvering v. Russian Finance & Const. Corp.*, 77 F. (2d) 324 (C. C. A. 2d, 1935); *Comm'r. v. St. L. S. W. Rly. Co.*, 66 F. (2d) 633 (C. C. A. 8, 1933); *Comm'r. v. So. Rly. Co.*, 74 F. (2d) 887 (C. C. A. 4, 1935); *Ill. Terminal Co. v. Comm'r.*, 5 B. T. A. 15 (1926); *Cinn., Findlay & Fort Wayne Rly. v. Comm'r.*, 5 B. T. A. 108 (1926); *Va., Carolina Securities Corp. v. Comm'r.*, 6 B. T. A. 84 (1927); *New Orleans, Tex. & Mexico Rly. v. Comm'r.*, 6 B. T. A. 436 (1927); *Great Northern Rly. Co. v. Comm'r.*, 8 B. T. A. 225 (1927); *Kahuku Plantation Co. v. Comm'r.*, 12 B. T. A. 977 (1928); and *Linderman, Exor., v. Comm'r.*, 28 B. T. A. 113 (1933).

ited and inelastic period of time within the taxable year or taxable period, often resulting in a conflict with a reasonably fair result to either the government or the taxpayer, is the source of most of the irritations and complexities of the problem."

More to the point, how can citation of the "annual accounting principle" possibly support the Circuit Court's refusal to apply Section 43 of the 1936 Revenue Act when that statute is expressly designed to countenance departures from such principle? Section 43 provides that deductions and credit shall be taken:

"... for the taxable year in which 'paid or accrued' or 'paid or incurred' ... unless in order to clearly reflect the income the deductions or credits should be taken *as of a different period.*" (Emphasis supplied).

Section 43 expressly and unequivocally permits deductions to be taken in some year other than the year of payment or accrual if (a factual problem we shall presently treat) such be necessary truly to reflect income. *In fact, the very purpose of Section 43 is to abolish the requirement that deductions be taken only in the year of payment or accrual.* Thus (if authority for this obvious assertion be necessary), see 1 Paul & Mertens, *supra*, § 11.104, p. 596:

"This provision [Sec. 43], allowing deductions or credits to be taken in a period different from that in which they are paid or accrued, or paid or incurred, was designed to ameliorate some of the hardships connected with the taxable year as a unit of time and we may expect that in the future it will be more often resorted to in a remedial way."

Again, see 2 Mertens, *supra*, § 12.22; p. 162:

"The [present] Code and prior acts provide that deductions and credits (other than the corporation dividends paid credit provided in section 27) are to be taken for the taxable year in which 'paid or accrued' or 'paid or incurred', dependent upon the method of accounting upon the basis of which the net income is computed, unless in order clearly to reflect the income the deductions or credits should be taken as of a different period. In other words, the usual method of accounting employed by the taxpayer may be departed from with respect to deductions and credits, if income will be more clearly reflected by shifting the item to another year or accounting period. *This provision was designed to ameliorate some of the hardships connected with the taxable year as a unit of time.*" (Italics added.)

The Eighth Circuit Court of Appeals in the Cannon Case, *supra*, made short shrift of this contention, saying (129 F. (2d) at 645):

"... it is clear that this clause [the 'unless' clause of Section 43] does interfere with the conception of an inescapable, 'straight jacket' annual basis wherein all deductions must appear as paid or finally accrued. *Obviously, the clause was intended to do just that for that is what it says.*" (Italics ours.)

The Tenth Circuit Court of Appeals cites no authority to support its disregarding the plain letter of Section 43, nor, we submit, does any such precedent exist. The decisions cited to that court by the Commissioner, and which, presumably, will be relied upon by the Commissioner here, furnish no justification for the decision below. Many, even most, of those decisions were decided prior to enactment of Section 43 or involved controver-

sies relating to pre-1924 taxable years.⁽²⁾ Hence, they cannot possibly be determinative here.

Several discuss not *when* but *whether* a controversial item is income or a proper deduction.⁽³⁾ That is not

(2) *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 75 L. ed. 383 (1931) (involved tax years 1913 through 1920); *Heiner v. Mellon*, 304 U. S. 271, 82 L. ed. 1337 (1938) (involved tax year 1920); *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 76 L. ed. 1197 (1932) (involved tax years 1917 through 1922); *Lucas v. American Code Co.*, 280 U. S. 445, 74 L. ed. 538 (1930) (involved tax year 1919); *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115, 74 L. ed. 733 (1930) (involved tax year 1920); *Lewellyn v. Electric Education Co.*, 275 U. S. 243, 72 L. ed. 262 (1927) (involved tax year 1918); *U. S. Cartridge Co. v. U. S.*, 284 U. S. 511, 76 L. ed. 431 (1932) (involved tax years 1918 through 1922); *Burnet v. Huff*, 288 U. S. 156, 77 L. ed. 670 (1933) (involved tax year 1920); *Highland Milk Condensing Co. v. Phillips*, 34 F. (2d) 777 (C. C. A. 3, 1929) (involved tax years 1917-1918); *Price Iron & Steel Co. v. Burnet*, 45 F. (2d) 921 (App. D. C., 1930) (involved attempt to relate back to 1920 loss sustained in 1925); *Chicago, R. I. & P. Rly. Co. v. Comm'r*, 47 F. (2d) 990 (C. C. A. 7, 1931) (involved tax years 1916 through 1919); *Uvalde Co.*, 1 B. T. A. 932 (1925) (involved tax year 1921); *Morrison-Ricker Manufacturing Co.*, 2 B. T. A. 1008 (1925) (involved tax years 1917 through 1920); *Celluloid Co.*, 9 B. T. A. 989 (1927) (involved tax years 1918 through 1920); and *Trippensee Manufacturing Co.*, 15 B. T. A. 15 (1929) (involved tax year 1921).

(3) *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 75 L. ed. 383 (1931) (whether compensatory award for breach of contract was income or return of invested capital); *Heiner v. Mellon*, 304 U. S. 271, 82 L. ed. 1337 (1938) (whether profits from sales made during a long-continuing liquidation of a partnership business are income); *Brown v. Helvering*, 291 U. S. 193, 78 L. ed. 725 (1934) (whether reserve for anticipated cancellations of commission was deductible); *U. S. Cartridge Co. v. U. S.*, 284 U. S. 511, 76 L. ed. 431 (1932) (whether increase of market value over inventory value of goods was income); *U. S. v. Safety Car Heating & L. Co.*, 297 U. S. 88, 80 L. ed. 500 (1935) (whether patent infringement recovery was capital, and whether difference between estimated value of the "chase in action" and amount of recovery is a deductible loss); *Ben Bimberg & Co. v. Helvering*, 126 F. (2d) 412 (C.C.A. 2d, 1942) (whether taxpayer could deduct from taxable refund received the amount of credits given to customers but later—next year—canceled); *Penn v. Robertson*, 115 F. (2d) 2d) 167 (C.C.A. 4, 1940) (whether "credits" received are income if taxpayer never receives benefit therefrom); *Uvalde Co.*, 1 B.T.A. 932 (1925), (whether "reserves" deductible); and *Morrison-Ricker Manufacturing Co.*, 2 B.T.A. 1008 (1925) (whether "reserves" deductible).

our problem. Others deal with the related but distinguishable question of when an item of *gross income* is to be accounted for as such.⁽⁴⁾ Few of the opinions contain any indication of whether the item in controversy would, however treated, be of significance in determining "true income" of the taxpayer, and at least one case (*Brown v. Helvering*, 291 U. S. 193, 78 L. ed. 725, 1934) dealt with routine, recurring items.

Further, we concede, of course, that *ordinarily* deductions must be taken as of the taxable period during which they are paid, incurred, or accrued. We merely contend—and this is all the Cannon decision holds—that *under exceptional circumstances, where to follow the usual practice would distort the taxpayer's income*, Section 43 permits deductions to be taken as of a different period. Yet nearly every one of the Commissioner's authorities is an "ordinary" case—a case in which there was no evidence introduced or contention advanced that the Commissioner's computation method failed truly to reflect income, in which Section 43 (or, for that matter, Sections 41 or 42) was not relied upon, discussed, or

(4). *Heiner v. Mellon*, 304 U. S. 271, 82 L. ed. 1337 (1938); *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 76 L. ed. 1197 (1932); *U. S. Cartridge Co. v. U. S.*, 284 U. S. 511, 76 L. ed. 431 (1932); *U. S. v. Safety Car Heating & L. Co.*, 298 U. S. 88, 80 L. ed. 500 (1935); *Guaranty Trust Co. v. Comm'r.*, 303 U. S. 493, 82 L. ed. 975 (1938); *London-Butte Gold Mines Co. v. Comm'r.*, 116 F. (2d) 478 (C. C. A. 10, 1940); *Comm'r. v. Alamitos Land Co.*, 112 F. (2d) 648 (C.C.A. 9, 1940); *Jamaica Water Supply Co. v. Comm'r.*, 125 F. (2d) 512 (C.C.A. 2d, 1942); and *Sportwear Hosiery Mills v. Comm'r.*, 429 F. (2d) 376 (C.C.A. 3rd, 1942).

even referred to, and in which no issue was raised concerning true reflection of income. (5) Palpably, therefore, these decisions are not controlling in the case at bar.

Nor, we submit, is any of these decisions authoritative here merely because it was decided after enactment of Section 43. Obviously decisions rendered, or involving taxable years prior to 1924 cannot be material. But neither is a decision rendered after 1924 (and involving a post-1924 taxable year) which does not purport to determine the effect of the statute. Section 43 does not affect the traditional requirement that deductions be taken for the year in which they are paid, accrued, or incurred *unless* adoption of the usual procedure fails "to clearly reflect income". Hence, after 1924 as before, courts properly adhere to the old requirement *where no showing or contention of "distortion" is made.*

(5) *North American Oil Consolidated v. Burnet*, 286 U. S. 417, 76 L. ed. 1197 (1932); *Lewellyn v. Electric Education Co.*, 275 U. S. 243, 72 L. ed. 262 (1927); *U. S. Cartridge Co. v. U. S.*, 284 U. S. 511, 76 L. ed. 431 (1932); *Burnet v. Huff*, 288 U. S. 156, 77 L. ed. 670 (1933); *U. S. v. Safety Car Heating & L. Co.*, 297 U. S. 88, 80 L. ed. 500 (1935); *Guaranty Trust Co. v. Comm'r.*, 303 U. S. 493, 82 L. ed. 975 (1938); *Saunders v. Comm'r.*, 101 F. (2d) 407 (C.C.A. 10, 1939); *London-Butte Gold Mines Co. v. Comm'r.*, 116 F. (2d) 478 (C.C.A. 10, 1940); *Highland Milk Condensing Co. v. Phillips*, 34 F. (2d) 777 (C.C.A. 3, 1929); *Price Iron & Steel Co. v. Burnet*, 45 F. (2d) 990 (App. D. C., 1930); *Chicago, R. I. & P. Rly. Co.*, 47 F. (2d) 990 (C.C.A. 7, 1931); *Comm'r. v. Alamitos Land Co.*, 112 F. (2d) 648 (C.C.A. 9, 1940); *Jamaica Water Supply Co. v. Comm'r.*, 125 F. (2d) 512 (C.C.A. 2d, 1942); *Ben Bimberg & Co. v. Helvering*, 126 F. (2d) 412 (C.C.A. 2d, 1942); *Sportwear Hosiery Mills v. Comm'r.*, 129 F. (2d) 376 (C.C.A. 3rd, 1942); *Griffin v. Smith*, 101 F. (2d) 348 (C.C.A. 7, 1939); *Penn v. Robertson*, 115 F. (2d) 167 (C.C.A. 4, 1940); *Uvalde Co.*, 1 B.T.A. 932 (1925); *Morrison-Ricker Mfg. Co.*, 2 B.T.A. 1008 (1925); *Trippensee Mfg. Co.*, 15 B.T.A. 15 (1929); *South Dakota Concrete Products Co.*, 26 B.T.A. 1429 (1932).

Therefore cases adduced by the Commissioner⁽⁶⁾ for the proposition:

"Notwithstanding the advent of this clause [Sec. 43] the courts have adhered to the principles outlined in the preceding branch of the discussion, just as they did before that time" (Comm'r's Brief to the Tenth Circuit Court, p. 39),

prove nothing merely because of their recent vintage.

Of all the Commissioner's numerous authorities, only eight, we submit, are even arguably analogous. In none of the others is Section 43 (or, for that matter, Section 41, 42, or any comparable statute) involved, relied upon, or mentioned; and in none of them is there any showing or contention of an extraordinary situation requiring that a deduction be taken in another period than that in which it was paid, accrued, or incurred, in order clearly

(6) *Guaranty Trust Co. v. Comm'r.*, 303 U. S. 493, 82 L. ed. 975 (1938); *Penn v. Robertson*, 115 F. (2d) 167 (C.C.A. 4, 1940); *Griffin v. Smith*, 101 F. (2d) 348 (C.C.A. 7, 1939); *Saunders v. Comm'r.*, 101 F. (2d) 407 (C.C.A. 10, 1939); and *South Dakota Concrete Products Co.*, 26 B.T.A. 1429 (1932). Other post-Section 43 opinions relied upon by the Commissioner before the Circuit Court are: *London-Butte Gold Mines Co. v. Comm'r.*, 116 F. (2d) 478 (C.C.A. 10, 1940); *Price Iron & Steel Co. v. Burnet*, 45 F. (2d) 921 (App. D. C., 1930) (though here a 1925 loss was sought to be related back to the tax year 1920 which was prior to Section 43's enactment); *Brown v. Helvering*, 291 U. S. 193, 78 L. ed. 725 (1934) (here, however, though the tax years of 1923, 1925, and 1926 were involved, the only substantial tax in litigation was that relating to 1923, a pre-Section 43 tax year); *U. S. v. Safety Car Heating & L. Co.*, 297 U. S. 88, 80 L. ed. 500 (1935) (here, again, the attempt was to relate a 1925 item back to 1913, a pre-Section 43 tax year); *Comm'r. v. Alamitos Land Co.*, 112 F. (2d) 648 (C.C.A. 9, 1940); *Jamaica Water Supply Co. v. Comm'r.*, 125 F. (2d) 512 (C.C.A. 2, 1942); *Ben Bimberg & Co. v. Helvering*, 126 F. (2d) 412 (C.C.A. 2, 1942); *Sportwear Hosiery Mills v. Comm'r.*, 129 F. (2d) 376 (C.C.A. 3, 1942); *Stokes v. U. S.*, 19 F. Supp. 577 (S. D. N. Y., 1937); and *De Loss v. Comm'r.*, 28 F. (2d) 803 (C.C.A. 2d, 1928).

to reflect income. Those eight cases we shall discuss, very briefly.

(1) *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 75 L. ed. 383 (1931).

The taxable years involved were 1913 through 1916, and 1920; hence Section 43, enacted in 1924, was not considered and the decision cannot therefore control here. Also, although Section 212 (b) of the 1918, 1921, 1924, and 1926 Acts (present Sec. 41) was perhaps applicable, the court specifically points out that the taxpayer made no attempt to avail himself of its provisions (282 U. S. at 366, 75 L. ed. at 388).

(2) *Heiner v. Mellon*, 304 U. S. 271, 82 L. ed. 1337 (1938). The taxable year in issue was 1920. Therefore, Section 43 was not involved. Question for determination was whether and when the taxpayer received "gross income". He neither contended nor proved the Commissioner's method of computation failed properly to reflect his income, and the court emphasized:

"Section 212 (b) of the Revenue Act of 1918 [present Section 41] provides that the net income shall be computed 'in accordance with the method of accounting regularly employed in keeping the books of the taxpayer, and it is not shown that the method employed clearly failed to reflect net income.' (304 U. S. at 277, 82 L. ed. at 1343; emphasis supplied).

In passing, we wish to suggest a distinction between Sections 41 and 42; on the one hand, and Section 43, on the other.

Section 41 enacts that net income shall be computed "in accordance with the *method of accounting* regularly employed in keeping the books of taxpayer"; but if no

such *method* of accounting has been employed, or if the *method* used does not clearly reflect income, then "the computation shall be made in accordance with such *method* as, in the opinion of the Commissioner does clearly reflect the income." Note this section says nothing as to the period in which items of income or deduction shall be taken. It gives no authority to account for such items in periods other than those in which paid, incurred, accrued, or received. *In fact, it does not even refer to individual items of account.* Rather, it deals with general *methods* of accounting (as, for example, cash and accrual).

Arguably, Section 42 goes little further. It does not expressly provide items of income may be accounted for in a period other than that in which received or accrued; It says, merely, that items of gross income "shall be included in the gross income for the taxable year in which received [not "or accrued"] by the taxpayer, unless, under *methods* of accounting permitted under Section 41, such amounts are to be properly accounted for as of a different period."

Section 43, on the other hand, expressly authorizes the taking of *individual items* of deduction or credit in a period other than that in which paid, accrued, or incurred, irrespective of the general accounting methods employed. The test under this statute is not whether taxpayer's *method of accounting* truly reflects income. Instead, it is whether accounting for a *particular deduction* in the year paid, accrued, or incurred truly reflects income.

Since there is a patent distinction between the treatment of isolated items (deductions) in an account, and a general "method of accounting" (*Stern Brothers*, 13 B. T. A. 1192, 1928), Section 43 is broader and more

pliable than either Section 41 or Section 42. At least it goes much further than Section 41.

We make these observations because several of the Commissioner's precedents consider when gross income is received, rather than when deductions may be taken; and because he will term Section 41 a "closely-related provision" to Section 43.

(3) *Lucas v. American Code Co.*, 280 U. S. 445, 74 L. ed. 438 (1930). Here taxpayer sought to reopen taxable year 1919 and deduct from that year's gross income a loss which was, in 1919, contingent as to both liability and amount, and which did not materialize until 1923. Since the tax year involved was 1919, Section 43 was inapplicable. No other statute existed authorizing the deduction to be taken in a year other than that (1923) in which it both accrued and was paid.

Taxpayer made no contention that his proposed accounting truly reflected and the Commissioner's distorted his income. And, as we have heretofore pointed out, Section 41 deals only with *general* methods of accounting and could hardly authorize taxpayer's treatment of this *individual deduction*.

The Court does note (280 U. S. at 449, 74 L. ed. at 540) that Section 41 requires the employment of accounting methods which truly reflect income, and comments that the Commissioner should be accorded "much latitude for discretion" in determining whether the method employed meets this test. However, this discretion is subject to review by the Board and Courts (*Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115, 74 L. ed. 733, 1930; *Hyams Coal Co. v. U. S.*, 26 F. (2d) 805, E. D. La., 1928; *Reynolds Cattle Co.*, 31 B. T. A. 206, 1934). For complete discussion of this, see 2 Mertens, *supra*, § 12.14,

p. 153, and the numerous authorities there cited. Again, although Section 41 specifically invokes the Commissioner's discretion; Section 43 does not. Finally, the Commissioner has never, in the case at bar, disallowed petitioner's contention upon the ground that petitioner's method does not properly reflect income. Instead, he has consistently maintained that *as a matter of law* the customer reimbursements cannot be accounted for in 1935, not because to do so fails truly to reflect income or because accounting for them in the years of payment does reflect income properly, but simply because no liability to make reimbursements accrued in 1935. Therefore his discretion, if it exists, is inoperative here (*Carondelet Bldg. Co. v. Fontenot*, 141 F. (2d) 267, C. C. A. 5, 1940).

(4) *Lucas v. Ox Fibre Brush Co.*, 281 U. S. 115, 74 L. ed. 733 (1930). The taxable years in controversy were 1909 through 1920. Therefore Section 43 was not considered. Nor did any comparable statute authorize the allocation, to income of prior years, of a voluntary bonus paid to taxpayer's officers in 1920. Note, incidentally, that there it was the Commissioner who sought to relate back the deduction. He cited Section 212 (b) of the 1918 Act (present Sec. 41) and asserted the taxpayer's "method of accounting" failed properly to reflect income. The court properly held this general statute gave no authority for taking this individual deduction in prior taxable periods.

(5) *Brown v. Helvering*, 291 U. S. 193, 78 L. ed. 725 (1934). The taxable years involved were 1923, 1925, and 1926. Section 43 (enacted in 1924) was, then, applicable to the latter two years. However, it was not cited, relied upon, or mentioned in the case—perhaps because the principal year in controversy was 1923 to which Section 43 was inapplicable. Deficiencies claimed were, for 1923,

\$17,923.03; for 1925, \$1,520.19; for 1926, \$944.30.) In any event, not having considered the application or effect of Section 43, this decision is not determinative of the instant case.

Furthermore, on its facts the Brown case is not in point. Taxpayer was an insurance agent. For each policy sold he received, monthly, an "overriding commission". In event the policy was later canceled, or the risk was reinsured, taxpayer's previously paid (or credited) commission was refunded (or canceled) pro tanto. From 1896 until 1923 taxpayer employed a regular *method of accounting* for these commissions. He reported as income all commissions earned during each taxable year; from that income he deducted all "rebates" suffered that year.

In 1923 taxpayer determined to change his regular method of accounting. He set up on his books a "reserve" for anticipated commission cancelations, based upon past experience, and from his gross commissions for 1923 he deducted in his 1923 tax return the amount of this reserve for return commissions. He followed the same procedure in his 1925 and 1926 returns. The Commissioner disallowed the deductions and assessed deficiencies.

Principal issue in the case was whether these "reserves" were deductible. The court held they were not, stating that the Revenue Acts recognized reserves, only in specified situations.

Taxpayer then argued the use of reserves constituted his "regular method of accounting" by which the Commissioner was bound, relying upon Section 41. Obviously, however, his regular method was that employed prior to 1923! Note, also, that taxpayer made no contention his earlier accounting practices failed properly to reflect income. The Commissioner, exercising the discretion vested

in him by Section 41, held taxpayer's former method truly reflected income, disallowed the change, and was sustained by the court. For the same reason the Commissioner disallowed taxpayer's alternative contention that he be permitted to prorate commissions over the life of the policies, and was upheld by the Court.

Plainly these facts distinguish the Brown decision from the instant case. Apart from the fact that the Brown case was primarily a controversy over whether, not when, a deduction may be taken, the taxpayer there did not contend his income was being distorted by the Commissioner's method of accounting. The return commissions were regular, routine, recurring items which, in the long run, would "balance off". Unquestionably either taxpayer's or the Commissioner's method would result in a fair reflection of income. Further, this was a true controversy concerning a general *method* of accounting—a system of handling numerous, recurring items—to which Section 41 fully applied. Finally, Brown did not assert any rights under Section 43, and that statute was not considered in the opinion.

(6) *De Loss v. Comm'r.*, 28 F. (2d) 803 (C. C. A. 2d; 1928). Taxable years involved were 1920 and 1921. Section 43 was therefore inapplicable, although its prototype Section 214 (a) (4) of the 1921 Act (limited to "losses") was in existence. Taxpayer owned stock in a corporation which in 1920 was dissolved, its affairs wound up, and most of its assets sold for less than outstanding debts. Plainly taxpayer's stock was worthless in 1920. Taxpayer sold part of his shares in 1920 and the balance in 1921, both for less than the broker's selling charge. He sought to deduct the loss sustained in each year. The court held the stock became worthless in 1920; could no longer fluctuate in value, and therefore the loss was of

necessity sustained in that year, the 1921 sale being purely fictitious.

There was no contention that accounting for the entire loss in 1920 did not properly reflect income. Of Section 214 (a) (4) of the 1921 Act (presumably—the court does not refer to it by section number) the court merely commented that it had no *retroactive application* to the tax year 1920 (the year the loss occurred):

“The express exceptions introduced in 1921, allowing such a practice, are to be taken as *ex gratia, and indicate no analogous intent in the earlier statute*. We hold that the loss upon the shares sold in 1921 was sustained in 1920.” (Italics ours).

(7) *Stokes v. U.S.*, 19 F. Supp. 577 (S. D. N. Y., 1937). The case involved the tax years 1927, 1928, and 1929. Section 43 was applicable. However, the taxpayer was held estopped to take his deduction in a year other than that in which it was paid, by reason of prior, inconsistent conduct in 1926, a year barred from readjustment by the statute of limitations. Further, Section 43 was held unavailable to taxpayer by reason of his failure to comply with Regulations 74.

(8) *Celluloid Company*, 9 B. T. A. 989 (1927). Most of the Board's opinion is concerned with irrelevant (here) issues of obsolescent-and-defective material deductions from inventory. The third issue involved taxpayer's right to deduct from 1920 income, largely derived from the sale of goods, returns in 1921 of defective goods sold in 1920. *This is the only case cited by the Commissioner in the instant cause wherein the taxpayer contended or proved that computing his income upon the “annual accounting period” basis would result in distortion.* In the Celluloid case, the taxpayer established

that goods returned in 1921 were in an extraordinary large amount (\$128,379.21) disproportionate to normal years' returns. However, the tax year in issue—1920—antedated Section 43 (as well as Section 214 (a) (4) of the 1921 Act), so there was no statutory authority for allowing the 1921 deduction to be taken as of 1920. Without reference to statute, the Board summarily held the liability did not accrue until 1921 and could not be accounted for in 1920, citing *Morrison-Ricker Mfg. Co.*, 2 B. T. A. 1008 (1925).

It is submitted that none of the authorities relied upon by the Commissioner in the Circuit Court denies that, under Section 43, a deduction may be accounted for in a year other than that in which paid, incurred, or accrued, if such be necessary in order clearly to reflect income. The statute itself unambiguously permits this to be done. And the Cannon case, *supra* (129 F. (2d) 642) is squarely opposed to the Tenth Circuit Court's decision herein. Compare, also, *Carondelet Bldg. Co. v. Fontenot*, 111 F. (2d) 267 (C. C. A. 5, 1940), and cases cited *supra* in footnote "(1)".

As a matter of fact, the Tenth Circuit Court's discussion of the "annual accounting principle" of income taxation is not, and cannot be, the reason for refusing to apply Section 43 in the case at bar — this for the simple reason that, undeniably, the "unless" clause of that statute expressly authorizes departures from this principle. The denial of Section 43's application was based upon legislative history which, the court held, discloses the "unless" provision was intended to apply only:

"... in cases in which the taxpayer pays in one year interest, or rental, or other items for a period of years, and to other instances of that character, in order to prevent distortion of income of the tax-

payer. It is manifest that Congress had in mind for application of the provision only instances in which a taxpayer receives income or makes expenditures in one year which are attributable to or related to business operations extending over a number of years."

Section 43, however, is unambiguous and clearly supports the construction given it by the Eighth Circuit Court in the Cannon case, *supra*, and by the dissenting opinion of Mr. Justice Phillips in the case at bar. It provides "deductions" shall be taken in the year paid, incurred, or accrued:

"... unless in order to clearly reflect income the deductions and credits should be taken as of a different period."

The sole test laid down by the statute is whether the taking of deductions in the year of payment or accrual *clearly reflects income*. There is no suggestion that only certain *types* of deductions or credits may be granted Section 43's benefits. The statutory determinant is not the type of deduction or credit, but, instead, is whether the deduction or credit, *whatever its type*, should be taken as of a period different from that of payment or accrual *in order clearly to reflect income*.

That being true, irrespective of what Congress may have thought, proposed, or intended, the statute is to be interpreted and applied according to what it clearly and unmistakably says. Resort cannot be had to committee reports or any other extraneous evidence to interpret or restrict an unambiguous statute. Thus see, *Helvering v. Cannon Valley Milling Co.*, *supra*, 129 F. (2d) at 645;

"The Report [the Committee Report upon which This Court relies in the case at bar] states the occasion of the provision in section 43 but the language of the section is more general than the reason stated in the Report. Had the Congress intended to limit this section to instances where 'a taxpayer pays in one year interest or rental payments or other items for a period of years,' it would have been easy to say so (compare section 107, Revenue Act of 1939, 26 U. S. C. A. Inc. Rev. Code, § 107). We have no difficulty in saying that the section includes the situations stated in the report. However, we cannot write into the section such a limitation on the ground that the expression in the Committee Report suggests such action."

Cases in support of this principle are legion, among them: *Helvering v. City Bank Farmers Trust Co.*, 296 U. S. 85, 89, 80 L. ed. 62, 66 (1935), unofficial headnotes 2 and 3; *Wilbur v. U. S., ex rel., Vindicator Consol. G. Min. Co.*, 284 U. S. 231, 237, 76 L. ed. 261, 264 (1931), unofficial headnote 2; *United States v. Missouri P. R. Co.*, 278 U. S. 269, 278, 73 L. ed. 322, 376 (1929), unofficial headnotes 2 and 3; *Federal Deposit Ins. Corporation v. Gunderson*, 106 F. (2d) 633 (C. C. A. 8, 1939); and *United States v. Board of Comm's.*, 26 F. Supp. 270 (N. D. Okla., 1939). For numerous authorities accord, see American Digest System, "Statutes", Key Numbers 190, 216, and 217.

Furthermore, the Tenth Circuit Court's interpretation of Section 43 is not supported by the committee report upon which it is purportedly based. That report (R. 64) states the occasion for the enactment of Section 43 (actually section 200 (d) of the 1924 act)—to extend to deductions and credits the rights previously (1921 Act)

granted only to "losses". It also gives illustrative cases wherein proposed Section 43 might be applied. But nowhere is there any suggestion that the Committee intended or desired Section 43, if enacted, should be *restricted* to the examples outlined. In fact, we submit the Committee's own language demonstrates conclusively that no restriction as to type of deduction was intended:

"The Revenue Act of 1921 * * * authorizes the Commissioner to allow the deduction of losses [note that no special *types* of losses are specified] in a year other than that in which sustained when, in his opinion, it is necessary to clearly reflect the income. *The proposed bill extends that theory to ALL deductions and credits.*" (Italics and capitalization supplied.)

We submit the Tenth Circuit Court's opinion is erroneous, first for construing unambiguous Section 43 and restricting its plain terms by resort to legislative history, and, second, for misinterpreting the legislative history relied upon by attributing to the Committee Reports a restrictive effect not therein stated.

What has just been said is equally applicable to the arguments proposed to the Tenth Circuit Court by the Commissioner (but not adopted by the Court in its opinion), (a) that Section 43 applies only to items of deduction "such as interest or rent" which help produce income, and (b) that Section 43 is restricted to payments made in one year of interest, rent, or similar items for a period of *subsequent* years.

In addition, as to the first noted contention it will hereinafter be demonstrated that the deductions claimed in the case at bar fully satisfy the test of helping produce the income from which they are sought to be deducted. And as to the second contention, why Congress

should (or could) discriminate between a taxpayer whose deduction accrues in a year prior to that in which he seeks to take it, and one who desires the benefit of his deduction in a year subsequent to its accrual, is difficult to conceive. In any event, Section 43 permits the taking of deductions in a "different", not merely a "subsequent", period than that in which they accrue.

The Commissioner also urged, in the court below, that the Cannon decision makes "prosperity or lack of prosperity" the determinant in localizing tax deductions. This, we submit, is incorrect. Whether a given method of accounting, or treatment of items in an account, does or does not truly reflect income is an objective problem. While the solution might be affected by, it certainly does not depend upon "prosperity". Nor is there so much as an inuendo in the Cannon decision that, in resolving such issue, consideration will be given to whether true reflection of income will result advantageously either to the taxpayer or to the fiscus.

It is submitted that if relation of vendee reimbursements to 1935 income is necessary in order clearly to reflect petitioner's income, Section 43 requires that the deductions be taken as of 1935. This leaves for consideration a purely factual question.

B. Of the Facts Herein.

The basic facts here involved are fully set forth in the Board's opinion (R. 32-49) and do not require detailed restating.

In general, these facts are illustrative of the tremendous, *sui generis* tax problem with which first domestic processors of wheat throughout the United States were confronted during existence of the Agricultural Adjustment Act and the repercussions years following its ad-

judged invalidation. Never before (nor since) in our legal history have taxpayers been caught between the Scylla of a taxing statute which was declared unconstitutional, and the Charybdis of a "follow up" statute (Title III) which, ere the reverberations of its predecessor had died down, was introduced into Congress, enacted, and sustained by the courts. The processors were forced to solve an enormous problem sandwiched in between the two taxing statutes and caustically seasoned with the mustard of embittered public opinion and strained customer relationships.

Throughout the calendar year 1935 petitioner was subject to a tax of \$1.38 per barrel of flour processed (.30c per bushel of clean dry wheat, times the administratively promulgated conversion factor of 4.6 bushels per barrel). To meet this tax, petitioner was forced to increase the sales price of flour:

"The selling price consisted of the usual items of cost, plus normal profit, *and included in addition an amount sufficient to cover the processing tax.*" (R. 35; italics ours).

The result was that petitioner's apparent gross income for 1935 was enhanced by approximately \$100,000 (estimated amount: \$105,054.70—R. 39). This unnatural increment to gross earnings was due *entirely* to the processing tax, necessitating petitioner's sale of flour "tax on".

As of December 31, 1935, the close of the controversial taxable year, this was offset by an accrued liability for processing taxes (R. 34). However, on January 6, 1936, the A. A. A. was adjudicated unconstitutional and petitioner's processing tax liability was absolved (R. 34). Thereupon, "business necessity" (! !) required that pe-

petitioner reimburse its vendees for taxes collected from them in the sales price of flour, and never paid by petitioner to the Treasury.

In 1936, 1937, and 1938, petitioner repaid to its vendees \$45,865.90 (R. 33). Obviously these payments had absolutely no relation to the cost of earning income in the years of payment. Equally apparent is the fact that they had exactly \$45,865.90 to do with acquisition of petitioner's 1935 gross receipts. They represented refunds to vendees of taxes paid by them to petitioner in 1935 as part of the sales price of flour. Therefore, they constituted pro tanto reduction of petitioner's gross income from 1935 sales. In fact, this relationship between refunds and 1935 income was admitted by the Commissioner (Stipulation of Facts, page 3, par. 8. This stipulation, incorporated in the Board's findings (R. 33), appears to have been omitted by mistake from the record herein):

"The petitioner has made reimbursements to certain of its customers with respect to processing taxes included in sales prices of flour purchased by them during the period from May 1 to December 31, 1935, but not paid by petitioner to the Treasury Department of the United States, in the aggregate amount of \$45,865.90. Of this amount the sum of \$2,475.03 was disbursed during petitioner's taxable year 1936, \$41,879.50 in petitioner's taxable year 1937 and \$1,511.37 was disbursed during petitioner's taxable year 1938."

What effect do these items have upon petitioner's true income? Petitioner's 1936 and 1938 returns are not in evidence (R. 39—although their contents were disclosed in briefs filed with the Board), but its 1935 and 1937 returns sufficiently disclose that only by relating reim-

bursements to the year of sale can petitioner's income be truly reflected. The following chart shows petitioner's net income for 1935 and 1937 both as computed by the Commissioner (who relates reimbursements to the years of payment) and as computed by petitioner (by relating reimbursements to the year of sale):

YEAR	Deduction Taken In Years of Payment	Deduction Taken In Year of Sale	Difference
1935	\$114,050.23	\$68,184.33	\$45,865.90
1937	\$ 66,944.25 (loss)	\$25,064.75 (loss)	\$41,879.50

That chart speaks for itself. It shows conclusively that accounting for the refunds in the years of payment distorts the true picture of petitioner's income. The Commissioner's method of computation increases petitioner's *actual* net profits from 1935 business by considerably (\$22,318.43) more than one third, and it all but doubles *actual* loss from 1937 business.

For example, from normal business operations in 1937 petitioner suffered a loss of \$25,064.76. *In addition*, it paid out during that year \$41,879.50. But this latter item was not an expense of doing business in 1937. Nor are we able to follow the Commissioner's argument to the Circuit Court that, if anything, this "good will" reimbursement should be related forward to future years. It was paid to vendees who had purchased flour in 1935, for reasons and because of facts which transpired prior to 1937. It constituted a refund of that portion of petitioner's 1935 gross income which the vendees in question had contributed. In no event did this \$41,879.50 have any bearing upon petitioner's conduct of 1937 business.

Thus, assuming \$25,064.75 to be a normal milling loss for 1937, would petitioner likely discharge its salesmen and managers on the theory they had incompetently operated the mill at a \$66,944.25 loss that year? Suppose

an accountant were asked, on January 1, 1938, to prepare and submit to the Securities and Exchange Commission a financial report of petitioner. Or suppose Dun and Bradstreet received, early in 1938, inquiry as to petitioner's credit. Would a report to the commission be acceptable which, without explanation, simply included the item \$41,879.50 as a 1937 "expense", lumping that huge sum with petitioner's actual \$25,064.75 loss? Could Dun and Bradstreet honestly report petitioner's credit as a going concern on the basis of a \$66,944.25 business loss? Would a stockholder, given a financial report by petitioner's of its 1937 calendar year, become disgruntled at the management and decry the rising cost of doing business?

These are purely rhetorical questions. Upon any basis of fact or logic, the reimbursements relate entirely to business transacted and income earned in 1935. They are refunds of portions of petitioner's 1935 gross receipts and certainly, therefore, are deductions "of the kind that help produce the income". Although they did not accrue in 1935, technically speaking, nevertheless in order truly to reflect income they must be accounted for in that year.

The items in question are remarkably large—large enough to nearly double petitioner's actual 1935 profits and 1937 losses if artificially accounted for in the years of payment. The amount of money obtained from vendees in 1935 because of the then effective processing tax, and later refunded (\$45,865.90), is approximately two thirds of petitioner's total net income for 1935 (\$68,184.33). Nor are these exceptional items the type which can be expected to readjust themselves by recurrence.
(⁸) Rigid adherence to the taxable year as a unit of ac-

(⁸) See discussion of this factor by the Board in the Cannon case (44 B.T.A. at 771).

counting time ordinarily results in rough justice both to taxpayer and Government. Average business transactions of one year seldom result in sufficient abnormal gain or loss seriously to affect or distort the taxpayer's income from the entire year's business. More important yet, they, or similar items, may be expected to recur, in varying forms, in each of the ensuing years' business so that, in the long run, little would be gained by constantly readjusting computation of income for prior years. A furniture company may have to take back in one year a number of articles sold during the previous year; but the law of averages and business experience indicate that it will, by and large, suffer the same or a similar experience in most if not all of its business years. Also, minor items of this type are not of sufficient magnitude to affect true reflection of income for the year of sale. See Article 43-2 of Regulations 86 as indicating the Commissioner recognizes this factor of recurring overlapping of inconsequential items as one of the justifications for adherence to the annual accounting period. Here, however, we are dealing with a large item which petitioner cannot hope to absorb by recurrence of comparable situations in future years.

It can hardly be denied that the Commissioner's method of accounting, as sustained by the Tenth Circuit Court, fails clearly to reflect petitioner's 1935 income. A method of tax accounting which lists petitioner's net income for 1935 as \$114,050.23 (R: 30) fails clearly to reflect actual income by exactly \$45,865.90; it is, we submit, gross distortion of petitioner's true income picture. We submit that it was to relieve against just such a situation that Section 43 was enacted.

The hard truth of the matter is that the Commissioner has never contended and the Tenth Circuit Court of

Appeals did not hold either that petitioner's method of accounting does not or that the Commissioner's method does truly reflect petitioner's 1935 income. The decision below is predicated entirely upon the two propositions, (1) that Section 43 is inapplicable except to items paid in one year which relate to income earned over a period of several years—which, in turn, is based upon improper resort to and erroneous interpretation of Congressional Committee Reports, and (2) that the annual accounting system of income taxation must be rigidly adhered to. As has already been shown, neither of these proposition is valid. The vital consideration herein—that petitioner's income can be clearly reflected in accordance with the mandates of Section 43 only by relating the reimbursements back to 1935—stands undenied either by the Commissioner or by the Tenth Circuit Court's decision.

Consideration should be given, too, to what the Eighth Circuit Court in the Cannon case, *supra*, terms the "injustices" of the Commissioner's position as sustained by the Tenth Circuit Court herein:

Petitioner did not seek the increment to its 1935 gross income caused by the Agricultural Adjustment Act and the consequent necessity for increasing the sales price of flour so as to include the tax. Prior, at least, to the close of 1935 petitioner received no benefit from these added gross receipts. It acted merely as a collecting agent for the fiscus, as a conduit through which the tax monies passed from vendee to the Treasury.

As is pointed out in the Cannon opinion, no financial gain and no tax increase were incurred by reason of these tax monies for the reason that the additional income was "offset by a claimed tax deduction". (129 F. (2d) at 646). At the end of the 1935 calendar year petitioner

was incontestably entitled to a deduction for accrued processing tax liability.

It should be borne in mind that not only the vendee reimbursements, but also the adjudication of the taxing statute's invalidity—which is the sole justification for the Commissioner's retroactive disallowance of the tax deduction—occurred in subsequent calendar years. Yet when the Commissioner disallowed the tax deduction in 1937 upon the basis of facts transpiring in 1936 (adjudication of the Act's unconstitutionality), thereby reopening the 1935 calendar year, he refused to reopen that year for all purposes and denied petitioner the right to substitute, in lieu of the deduction for accrued processing taxes never paid, a deduction for that portion of 1935 income never retained by petitioner but refunded to vendees. Certainly if the tax year 1935 is to be reopened and the entire deduction for taxes disallowed, petitioner should be entitled to offset its loss of deduction to the extent it actually reimbursed its vendees in 1936, 1937, and 1938. If the A. A. A. is now to be completely ignored and petitioner's 1935 gross income item to be considered final, the Commissioner must be consistent in his treatment of the liability item. If hindsight may be employed to treat the liability (for taxes) item as tentative from its inception, it must also observe the equal tentativeness of the income item. Just as a deduction is disallowed for processing tax liability the actual *burden* of which, although the liability actually accrued and the tax was actually paid to the depository, petitioner never suffered, so deduction must be granted for that portion of gross income from flour sales the *benefit* of which, though the right thereto once accrued and though the monies were once paid to petitioner, the petitioner never realized. By ignoring the A. A. A. the Commiss-

sioner has restored to income for 1935 monies not includable therein as of December 31 of that year. To be consistent he must allow a deduction to the extent of the \$45,865.90 reimbursements. If the parties are to be placed back into status quo, as though no processing tax had been enacted, the restoration process must be applied to the entire picture; petitioner's gross income for 1935 is that amount of money it would have obtained had there been no A. A. A., which sum is *at least* \$45,865.90 less than the figure asserted in the Commissioner's deficiency and upheld by the Tenth Circuit Court.

Inasmuch as all the relevant facts herein had become final and known prior to the Commissioner's deficiency assessment, there appears no reason for his refusing to take *all* such facts into consideration. Why should he not be compelled to take into account the customer reimbursements actually paid as well as the release of impounded monies as a consequence of the A. A. A.'s unconstitutionality? *Bohemian Breweries, Inc. v. U. S.*, 27 F. Supp. 588 (Ct. of Claims, 1939) appears to justify consideration of all factors crystalizing while "a case involving audit and determination of correct tax liability is open and under consideration". Compare *E. B. Elliott Co.*, 45 B. T. A. 82 (1941), and see Mr. Justice Cardozo's recognition of Experience's prowess as a great teacher, in *Sinclair Refining Co. v. Jenkins Petroleum Process Co.*, 229 U. S. 689, 77 L. ed. 1449 (1933).

As the Eighth Circuit Court quite properly said, in the Cannon case (129 F. (2d) at 646):

"To permit the Commissioner to open up the item of deduction only to the extent it serves his purpose and to deny the taxpayer the effect of the reimbursements affecting the same item resulting in its paying a higher tax than it justly owes is an injustice to the taxpayer."

We submit that, in all fairness, and in order clearly to reflect income, it is essential that customer reimbursements paid by petitioner be allowed as a deduction from 1935 gross income.

The Cannon Valley Milling Company decision, *supra*, squarely supports petitioner's contention and is in direct conflict with the instant Tenth Circuit Court opinion. Nor is there, we submit, any factual distinction between the Cannon case and the case at bar. As was noted by the Board of Tax Appeals in the present case (R. 44):

"There is no substantial difference between the facts in the instant proceeding and those in the cited [Cannon] case."

The only distinction suggested by the majority opinion in the present case is that in the Cannon case the tax returns for 1935, 1936, 1937, and 1938 were in evidence, whereas here only the 1935 and 1937 returns were introduced (R. 65). This "distinction" lacks substance for at least four reasons:

(1) The Cannon decision is not predicated upon any factual matter disclosed by post-1935 tax returns. The entire rationale of the Eighth Circuit Court's opinion is contained in the first full paragraph entitled "Application" (129 F. (2d) at 646), and the facts there relied upon are not peculiar to the Cannon Valley Milling

Company; instead, they are general facts common to most, if not all, processors*—including petitioner.

To prove this, we quote the first full paragraph of the court's opinion (p. 646) :

"[3] *Application.* In the months of May and June, 1935, this taxpayer collected the processing tax as a part of its sales prices. In its tax return for that year, the amount of such collections was included in its gross income and was entirely offset by a claimed tax deduction. The result was that the collections had no effect upon its net income. Three years later, the Commissioner redetermined the tax by disallowing the deduction. Since this disallowance left the gross income (which included the collections) undisturbed, the result would be that the net income would be increased by the amount of the collections. It was not until 1936 that the contingency (validity *vif* non of the A.. A. Act) was resolved and the right of taxpayer to the accrued income from the collections was determined. Therefore, the disallowance by the Commissioner was a relation back to the tax year 1935 of an accrual which had become fixed in a later year. At the time of the redetermination it was established that only a part of the collections had remained the property of

(*) In fact, since the tax applied to all processors alike, and since each processor necessarily passed on to its vendees approximately the same proportion thereof as did all others, and since nearly every processor was compelled to give to its vendees approximately the same settlement as other processors extended to theirs, the factual situation of most processors is nearly identical. The only variance is in amounts, which is immaterial since the relation between gross income, taxes included in sales prices, and reimbursements is substantially constant—so, *proportionately*, the effect upon each processor of accounting for reimbursements in the year of sale will be the same. That is, to the extent that one processor's gross income in 1935 exceeded another's, to that same extent, and in the same relative proportion, his "taxes collected" from and reimbursements paid to vendees were likewise larger. The net result upon true reflection of income, by relating reimbursements to the year of sale, will be the same in each case.

the taxpayer and a part of its income. All the taxpayer seeks is to have related back, from 1937, the disbursements which reduced the collections in order that its net income for 1935 will be "clearly" and truly stated. Both the deduction and the reimbursements relate to the same transaction in 1935. Clearly to disallow the deduction and to refuse the decrease thereof by the reimbursements will distort the taxable income for that year. To permit the Commissioner to open up the item of deduction only to the extent it serves his purposes and to deny the taxpayer the effect of the reimbursements affecting the same item resulting in its paying a higher tax than it justly owes is an injustice to the taxpayer."

That is, we submit, the nub of the Eighth Circuit Court's opinion, and it contains no reference to 1936, 1937, and 1938 tax returns or to any other special circumstance peculiar to the processor involved in that action.

Having held, upon the aforesaid facts alone, that "to disallow the deduction and to refuse the decrease thereof by the reimbursements will distort the taxable income for that year" (129 F. (2d) at 646), the court then, and not until then, proceeded to consider the special facts of that case including the tax returns mentioned herein by the Tenth Circuit Court. But in so doing, the Eighth Circuit Court designedly characterized these special facts as merely *further, additional* evidence of distortion:

"The distortion of income and resulting injustice is further emphasized by other evidence. . . ." (129 F. (2d) at 646).

In this connection, compare the Board's opinion in the case at bar (R. 44).

(2) Perhaps more important, the Commissioner's argument and the Tenth Circuit Court's ruling flatly deny Section 43's application in favor of *any* mill in petitioner's general situation. The only purpose served by introduction of tax returns for the years 1935 through 1938 could be to demonstrate the *quantum* of difference between deducting vendee reimbursements from income of the year of sale (1935), and deducting them from income of the years of payment; that is, to show distortion of true income reflection save by relating payments back to 1935. Yet even were petitioner able to establish a \$50,000,000,000.00 distortion of its true 1935 income if reimbursements are charged against income of the years of payment, nevertheless the *nature* of those reimbursements would not thereby become changed to "expenditures in one year which are attributable to or related to business operations *extending over a number of years* * * * [such as], * * * interest, or rental, or other items of *that kind covering a period of years*" (R. 64). Therefore the Tenth Circuit Court's opinion would deny petitioner the right to avail itself of Section 43. By the same token no wheat processor could adduce any evidence which would entitle it to the benefits of Section 43 as interpreted by the Tenth Circuit Court. Undeniably the reimbursements paid by the Cannon Valley Milling Company to its vendees were of precisely the same *character* as those paid by present petitioner, nor were the Cannon Mill's payments classifiable as "interest, or rental, or other items of that kind covering a period of years". Therefore the conflict between the two decisions cannot be resolved upon a factual basis.

(3) Again, as already noted, in discussing the Cannon Mill tax returns (after having already determined the point at issue, and under the cumulative introduc-

tion, "The distortion of income and resulting injustice is further emphasized by *other* evidence"—129 F. (2d) at 646; italics added), the Eighth Circuit Court did not consider or discuss the 1938 return. The chart relied upon by the court (129 F. (2d) at 647) contains only figures for 1935, 1936, and 1937. The reason for including the year 1936 was that the Cannon Mill made its returns upon a fiscal year basis—not according to the calendar year as in the case at bar—and its 1936 fiscal year commenced July 1, 1935 (129 F. (2d) at 647). As a matter of fact, the aforesaid chart indicates that 1936 returns were actually not in evidence even in that case (note the absence from said chart of any figure for 1936 under the heading "Reported on return"—129 F. (2d) at 647).

In addition, although, of course, the figures vary somewhat, the evidence discloses distortion by application of the Commissioner's method of tax computation in the case at bar as clearly as in the *Cannon* case. According to the aforementioned chart, the Cannon Mill's total "income" for 1935 was \$50,464.03, yet if subsequent reimbursements are charged against that income, its actual net profit was \$21,040.58—a difference of \$29,432.45. In the case at bar, petitioner's 1935 income without giving credit to subsequent reimbursements was \$114,050.23 (R. 30). If such reimbursements are charged against that income, petitioner's actual 1935 profit is \$68,184.33—a difference of \$45,865.90 (R. 35, 37).

(4) Finally, the only taxable year in controversy is the calendar year 1935. The evidence before the Board was sufficient to support (and, in our opinion, to compel) the Board's *factual* determination that the Commissioner's method of computing petitioner's 1935 in-

come did not truly reflect but, in fact, distorted its income for that year.

What more, then, was necessary? If the record shows that in order clearly to reflect 1935 income it is necessary to relate 1936-1937-1938 vendee reimbursements back to that year, the requisite foundation for application of Section 43 has been laid. Certainly the record is complete in so far as figures for 1935 are concerned, showing "apparent" net income of \$114,050.23 (R. 30), reimbursements therefrom totalling \$45,865.90 (R. 35, 37), and, hence, actual net income for 1935 of only \$68,-184.33. We submit that evidence relating to calendar years subsequent to 1935 is immaterial here where the sole controversy concerns a deficiency assessment for the year 1935.

It is submitted that Section 43 is applicable here, and that the decision of the Tenth Circuit Court is erroneous and in direct conflict with that of the Eighth Circuit Court in the Cannon case, *supra*.

C. Of the Necessity for Compliance With Regulations 86.

In his brief to the Tenth Circuit Court the Commissioner urged Section 43 was unavailable to petitioner for failure to comply with Article 43-1 of Regulations 86 by taking deductions for reimbursements in its 1936, 1937, and 1938 returns and submitting with those returns a request that the deductions be shifted to 1935. No mention of this point was made in the majority opinion of the Tenth Circuit Court's decision. However, it was discussed in the dissenting opinion (R. 71) and will be treated here to forfend against its renewal before This Court. For several reasons the objection lacks merit.

In the first place, the Commissioneer advanced no such contention before the Board of Tax Appeals. The issue

was not raised in his answer before the Board, (R. 27-30), mentioned in his brief to the Board, or adverted to in oral argument.

It is a general principle of appellate law that no contention not submitted by appellant to the trial court will be considered on appeal.⁽⁹⁾ Legion are the decisions applying this rule to appeals from the Board of Tax Appeals.⁽¹⁰⁾ Recently certain qualifications upon this rule have been introduced, permitting departure therefrom under "exceptional circumstances" (*Hormel v. Helvering*, 312 U. S. 552, 85 L. ed. 1037, 1941; *Helvering v. Richter*, 312 U. S. 561, 85 L. ed. 1043, 1941). Thus, in the two cited authorities, the Commissioner was permitted to raise a new contention on appeal to the circuit court where This Court had enunciated a new, applicable rule of law *after* the Board's original opinion was handed down. Hence, the Commissioner had had no opportunity to present the issue to the Board. However, in the case at bar the regulation relied upon has been in existence since 1925, and there is, therefore, no excuse whatever for his failure to make the point before the Board. There being no exceptional circumstances to jus-

(9) For example, see: *New Amsterdam Casualty Co. v. Farmers' Co-op. Union*, 2 F. (2d) 214 (C.C.A. 8, 1924); *New York Life Ins. Co. v. Doerksen*, 75 F. (2d) 96 (C.C.A. 10, 1935); *American Home Fire Assur. Co. v. Hargrove*, 109 F. (2d) 86 (C.C.A. 10, 1940); and *Liberty Petroleum Co. v. California Co.*, 114 F. (2d) 980 (C.C.A. 10, 1940).

(10) *General Utilities & Operating Co. v. Helvering*, 296 U. S. 200, 80 L. ed. 154 (1935) (syl. 2); *Helvering v. Savage*, 297 U. S. 106, 80 L. ed. 511 (1936) (syl. 1); *Tulsa Tribune Co. v. Comm'r.*, 58 F. (2d) 937 (C.C.A. 10, 1932); *Covington v. Comm'r.*, 103 F. (2d) 201 (C.C.A. 5, 1939); *Schoenfeld v. Comm'r.*, 103 F. (2d) 964 (C.C.A. 9, 1939); *Rhodes v. Comm'r.*, 111 F. (2d) 53 (C.C.A. 4, 1940); *Phillips v. Comm'r.*, 112 F. (2d) 721 (C.C.A. 3, 1940); and *Helvering v. Achelis*, 112 F. (2d) 929 (C.C.A. 2, 1940). For countless authorities in accord, see American Digest System, "Internal Revenue", Key number 1603—and, in earlier series, Key number 25.

tify the Commissioner's belated action, we submit he is barred from relying upon his regulations.

In the second place, we agree with taxpayer's contention in the Cannon case (rejected by the court—129 F. (2d) at 648) that Section 43 does not warrant regulations requiring initial submission to the Commissioner's discretion of the question of "clearly reflecting income". Section 41 expressly invokes "the opinion of the Commissioner". Section 42 probably incorporates this by reference. The absence of comparable language in Section 43 is, in our opinion, of controlling significance.

In any event, as the dissenting opinion points out in the case at bar (R. 1), there was no occasion or justification for petitioner's claiming these deductions in post-1935 returns when the deduction had already been taken in its 1935 return as accrued processing tax liability. Compare the following language from the Cannon opinion (129 F. (2d) at 648, 649):

"The taxpayer had secured the benefit of the entire deduction in its return for 1935. It originated no movement, before the Commissioner or otherwise, to change this situation. The Commissioner disturbed the situation by a redetermination of the tax for 1935 through elimination of this deduction item. . . .

"Another controlling consideration is that these reimbursements are an intimate part of a definite transaction which the Commissioner is himself opening up. The matter opened up by the Commissioner here is the processing tax transactions of the taxpayer in May and June, 1935. The amount of such taxes was included in gross income and offset by the deductions for taxes in the return with the net result that they had no effect upon net income. The reimbursements obviously decreased the gross income by that much. If reduction by the reimburse-

ments is entirely disallowed it is obvious that the net income will be improperly increased to the amount of the reimbursements, although they are an intimate part of the transaction affecting the net income and the entire situation as to these taxes as reflected in 1935."

Finally, *lex neminem cogit ad vanam seu inutilia peragenda*—"the law forces no one to do vain or useless things". In the Cannon case (129 F. (2d) at 649) the court excused compliance with this regulation because attached to the Commissioner's deficiency notice was a statement that reimbursements could not be related back unless there were a prior definite agreement. This statement, said the court:

"... includes a direct ruling by him [Commissioner] that such reimbursements would not be considered in the adjustment unless 'a definite agreement to settle or compromise such claims was entered into with such vendees during the taxable year here under consideration.' (Italics added).

From this the court concluded:

"Therefore, the situation was that before the notice of redetermination there was no occasion for the taxpayer to comply with the regulation and after such notice the futility of such compliance was made definite by the Commissioner. An attempt to comply with the regulation, after the notice, would have been an idle gesture without result or effect upon the situation."

Exactly the same thing is true here. Although the notice of deficiency in the case at bar does not contain a statement of the Commissioner's attitude toward reim-

bursements, none was necessary. Long prior to receipt of the instant deficiency notice, petitioner was fully informed of the Commissioner's attitude and knew that, absent an express agreement in 1935 to make reimbursements, no deduction therefor would be allowed.

Had we anticipated the Commissioner intended to rely upon noncompliance with Regulations 86 we could have introduced evidence to show that immediately after the A. A. A. was declared unconstitutional (and both before and after enactment of Title III) petitioner's counsel commenced negotiating with the Commissioner concerning customer reimbursements and the treatment of the tax deduction. Numerous conferences were held in Washington. Petitioner submitted to the Commissioner lengthy written briefs on the precise issues here involved (see Record, p. 36, 37, for recognition by the Board below that such conferences occurred). Even prior to the filing of petitioner's 1936 return the Commissioner had taken the adamant stand that reimbursements could not be related back to 1935 unless definite agreements to make refunds were entered into during that year. Under *Hormel v. Helvering*, *supra*, 312 U. S. 552, and *Helvering v. Richter*, *supra*; 312 U. S. 561, no estoppel should be predicated upon petitioner's noncompliance with Regulations 86—an issue raised by the Commissioner for the first time in its Brief on appeal to the Tenth Circuit Court—without affording petitioner an opportunity of proving the known futility of appealing to the Commissioner's discretion.

Furthermore I. T. 3086, XVI-24-8756 (1937 C. C. H. *Federal Tax Service*, par. 6361, 6-23-37) and I. T. 3090, XVI-25-8769 (1937 C. C. H., *supra*, par. 6378, 7-1-37) are themselves positive proof that prior to the instant deficiency determination of June 21, 1937 (R. 19) the

Commissioner had gone on record as allowing the relation back of reimbursements *only* in event they were paid or contracted to be paid ("accrued") in 1935:

" . . . the entire amount of the selling price received from the purchasers for the commodities in respect of which the taxes were imposed, including any addition to the selling price as the result of such taxes, must be included in computing gross income, *unless during the taxable year the taxpayer rebated, or was under a legal contractual obligation to rebate,* to the purchasers the addition to the selling price on account of such taxes." (I. T. 3086; italics ours).

Also, G. C. M. 20134, 1938-22-9360 (1938 C. C. H. *Federal Tax Service*, par. 6313, 6-8-38) proves conclusively that any attempt at compliance with Regulations 86 would have been to no avail. Here, exactly as in the Cannon case, it is undeniable that:

"An attempt to comply with the regulation, after the notice [or before ! !] would have been an idle gesture without result or effect upon the situation."

In addition, we reiterate that the Commissioner has never yet denied petitioner's contention *on the ground* that accounting for the reimbursements in the years of payment clearly reflects income. Before the Board below he maintained the reimbursements could not be accounted for in 1935 because (a) no liability to make them accrued in 1935, and (b) Section 43 does not apply to prior, but only to subsequent taxable periods. He maintained that *irrespective of whether accounting for the reimbursements in the years of payment distorted taxpayer's true income* no relation back was permissible. He took much the same position in his brief to the

Tenth Circuit Court, and the decision of that Court likewise evades consideration of the "clear reflection of income" issue. In short, the Commissioner's position throughout has been that neither Section 43 nor any other statute or decision authorizes the taking of a deduction in a year prior to its accrual as a liability. This, he has maintained, is an inexorable rule of law. Unless a deduction is either paid or accrued within the taxable year, under no circumstances may it be accounted for in that period. The opinion of the Tenth Circuit Court adopted this position in reversing the Board's decision. Therefore, not only has the Commissioner failed to exercise his (alleged) "discretion" of determining petitioner's accounts fail properly to reflect income, and failed to adopt or urge this ground for rejecting petitioner's contention, (11) but he has even denied he possesses any such discretion—and the Tenth Circuit Court has agreed with him. Since the Commissioner (and the Tenth Circuit Court) takes the flat position that even to avoid distortion of income it is not permissible, under Section 43 or otherwise, to violate the "annual accounting principle" by taking a deduction in an earlier period than that in which it is paid or accrued, how can it be denied that taxpayer's compliance with Regulations 86 would have been futile? Why seek the Commissioner's determination that relation back of the rebates to 1935 is essential to true income reflection when it was known then and has since been confirmed by his contentions throughout this case that he would have refused to consider this accounting fact, but, instead, would

(11) This fact is itself sufficient to preclude the Commissioner's reliance herein upon taxpayer's failure to comply with the regulation; *Carondelet Bldg. Co. v. Fontenot*, 111 F. (2d) 267, 269 (C.C.A. 5, 1940).

have peremptorily denied the request for the reason no liability to reimburse accrued in 1935?

It is submitted that Regulations '86 can play no proper part in the determination of the instant controversy.

II.

THE TENTH CIRCUIT COURT'S OPINION IS ERRONEOUS FOR THREE ADDITIONAL REASONS.

The fundamental issue for determination herein—whether the vendee reimbursements may be taken in 1935, under Section 43, in order clearly to reflect income—has already been discussed. We wish, however, to urge three additional grounds in opposition to the decision of the Tenth Circuit Court of Appeals.

A. \$106,604.02 of Petitioner's Gross Receipts for 1935 Did Not Constitute "Income" Until 1937 When Controversies as to Ownership Thereof Were Determined.

This contention was thoroughly briefed and argued to the Board. An excellent summary of petitioner's position is contained in the first portion of the Board's opinion (R. 40-41), and will not, for that reason, be restated here. For the authorities relied upon by petitioner, in addition to *Comm'r. v. Brown*, 54 F. (2d) 563 (C. C. A. 1, 1931), cert. den. 286 U. S. 556, 76 L. ed. 1291, see *Gugenheim Exploration Co. v. U. S.*, 238 Fed. 231, 237 (S. D., N. Y., 1917) and 1 Paul & Mertens, *Law of Federal Income Taxation* (1935), § 5.09, p. 111 (for authority that "receipts" are not synonymous with "income"); Roswell Magill, *Taxable Income* (1936), p. 181, and 1 Paul & Mertens, *supra*, § 11.23, p. 503 (for authority that monies received are not income if, and so long as, any "substantial contingency" remains that they may not be retained); and, in general, *Comm'r. v. Tur-*

ney, 82 F. (2d) 661 (C. C. A. 5, 1936). It should be particularly noted that petitioner refused to exercise dominion over these funds, and that it never denied the right of vendees to reimbursements (although it resisted two abortive law suits, which interfered with its attempts to reach amicable agreements with the majority of its vendees, *upon purely technical grounds*—R. 35).

B. The Uniqueness and Enormity of the Instant Problem Justifies Consideration of This Case as Involving a Single, Continuous Transaction, Correlating Gross Income and Reimbursements Accordingly.

This contention was briefed before the Board, and the Tenth Circuit Court, but is not mentioned in either opinion. The extraordinary, *sui generis* nature of the instant problem has already been emphasized herein. Because of its uniqueness and enormity, and because it is so unlikely to recur, we feel an exception to the "annual accounting period" rule should here be made in the interests of justice. All the relevant facts of this case are *in fact* part and parcel of one continuing transaction instigated by the A. A. A., aggravated by the statute's adjudicated unconstitutionality, protracted by enactment of Title III, complicated by conflicting claims and interests of vendees and the Government, and culminating in customer reimbursements. "Both the deductions", says the court in the Cannon case (129 F. (2d) at 646, "and the reimbursements relate to the same transaction in 1935." Therefore, under the peculiar circumstances herein, we submit the "transaction" approach may be applied. In support, we refer This Court to *Bowers v. Kerbaugh-Empire Co.*, 271 U. S. 170, 70 L. ed. 886 (1926.) Compare, *Comm'r. v. Darnell*, 60 F. (2d) 82 (C. C. A. 6, 1932), and *George G. Moore*, 19 B. T. A. 364 (1930).

C. The 1935 Tax Deduction Should Not Be Disturbed Irrespective of the Fact That the Taxing Statute Was Subsequently Held Unconstitutional.

Although the authorities on this proposition are not harmonious, there is respectable authority holding that the deduction properly taken in petitioner's 1935 income tax return for accrued processing tax liability cannot be disallowed merely because the taxing statute was subsequently declared unconstitutional and the tax was therefore never paid: *Davies' Estate v. Comm'r.*, 126 F. (2d) 294 (C.C.A. 6, 1942), and *J. H. Dougherty's Sons, Inc. v. Comm'r.*, 121 F. (2d) 700 (C. C. A. 3, 1941).

This contention was not raised by petitioner before the Board for the reason that the cited authorities had not then been decided. However, since it *supports* (pro tanto) the Board's denial of the tax deficiency, this is no obstacle to petitioner's raising the issue, as was done, before the Tenth Circuit Court of Appeals (*Helvering v. Gowran*, 302 U. S. 238, 82 L. ed. 224, 1937; *Rhodes v. Comm'r.*, 141 F. (2d) 53, C. C. A. 4, 1940). Also, that the Davies and Dougherty decisions were not rendered until after submission of the present case to the Board of Tax Appeals, would seem an "exceptional circumstance" within the rule enunciated by *Hormel v. Helvering*, *supra*, 312 U. S. 552, and *Helvering v. Richter*, *supra*, 312 U. S. 561.

This issue also was not mentioned in the Tenth Circuit Court's opinion despite its being urged in petitioner's brief (and renewed in its petition for rehearing).

CONCLUSION.

The outstanding single fact in this case—that petitioner's income for 1935 cannot be truly reflected save by accounting for its vendee reimbursements in that year—has never been denied by the Commissioner and is not controverted by the instant decision of the Tenth Circuit Court of Appeals.

This is a purely factual issue which the Board of Tax Appeals has determined in favor of petitioner.

Section 43 of the 1936 Revenue Act expressly provides for the taking of deductions in a year other than that of payment or accrual wherever necessary in order clearly to reflect income.

Therefore it is submitted that the judgment of the Tenth Circuit Court of Appeals herein is erroneous, is in direct conflict with the decision of the Eighth Circuit Court of Appeals in the Cannon Valley Milling Case, and should be reversed.

Respectfully submitted,

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